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Partnering strategies and performance of SMEs' international joint ventures

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Abstract

The international joint venture (IJV) is an important mode in the internationalization of small- and medium-sized enterprises (SMEs). Internationalization in turn is an entrepreneurial behavior in the pursuit of growth. Partnering strategies in the formation of IJVs can have significant effects on the outcome of SMEs' international expansion. In this study, we examine the performance implications of two types of resources contributed by SMEs' IJV partners, host country knowledge and size-based resources. We develop and test three sets of hypotheses about the longevity and financial performance of a sample of 1117 international joint ventures established in 43 countries by 614 Japanese SMEs that have fewer than 500 employees. Our findings indicate that SMEs' IJVs with local partner(s) may be associated with decreases in longevity, especially when SMEs acquire host country knowledge. The host country experience of Japanese partner(s) does not have any direct effects on IJV profitability but reduces the longevity of IJVs. Finally, the size of Japanese partner(s) increases the longevity of IJVs but may have negative effects on IJV profitability when large Japanese partners have low equity ownership in IJVs. Our findings highlight the differential effects that IJV partners' experience-based and size-based resources have on IJV performance. Our findings also demonstrate that the same strategy could have different effects on different dimensions of performance.

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1. Executive summary

The international joint venture (IJV), a form of strategic alliance, is an important means of international expansion. A growing number of small- and medium-sized enterprises (SMEs) have employed this mode in their expansion. Despite the increasing popularity of international joint venturing as an internationalization strategy for small and medium enterprises, the effectiveness of this strategy has been under-explored in the entrepreneurship literature. While researchers in the areas of strategy and international business have explored the performance of international joint ventures, they tend to focus on ventures established by large firms. Their findings may not be generalizable to SMEs' international joint ventures, given the significant differences between smaller and larger firms.

SMEs' foreign subsidiaries encounter three liabilities in their international expansion. They face liability of foreignness due to the lack of local knowledge, which can lead to disadvantages in competing with local firms who are familiar with the local environment. They are subject to liability of newness as newly established firms in the local market. As new firms, they face a series of challenges such as financing, staffing, securing relationships with suppliers and buyers, attracting local customers and ultimately establishing their legitimacy. Their third liability is one of smallness. By definition, small and medium enterprises have limited resources and capabilities. Given this characteristic of SME parent firms, their subsidiaries tend to be small in size and vulnerable to environmental change.

Forming international joint ventures and leveraging IJV partners' resources is a potential way to overcome these three liabilities. In this study, we explore how two types of resources, host country knowledge and size-based resources contributed by IJV partners, can help small and medium enterprises and their foreign subsidiaries mitigate one or all three of the liabilities and ultimately influence the performance of SMEs' international joint ventures. Taking into account both economic and social considerations, we develop and test three sets of hypotheses about the longevity and financial performance of a sample of 1117 international joint ventures worldwide established by 614 Japanese small and medium enterprises that have fewer than 500 employees.

We find that the size of Japanese partner(s) was positively related to the longevity of SMEs' international joint ventures, while either the use of local partner or the host country experience of Japanese partner(s) is associated with decreases in IJV longevity. The contrasting effects that experience-based and size-based resources had on IJV longevity point to the importance of considering the characteristics of resources contributed by IJV partners. When establishing international joint ventures, SMEs may want to contribute a diverse set of resources to reduce the obsolescence of the IJV bargain.

Our findings also indicate that the profitability of SMEs' international joint ventures may suffer when the home country partners are of large size and have low equity ownership in the IJVs. The results of our investigations point to the potential bargaining power asymmetry when SMEs form alliances with partners of large size. Our findings suggest that one way for SMEs to minimize the potential downside effect of bargaining power asymmetry is to increase the stake of large partners in the joint ventures to align the goals of both partners.

Finally, the contrasting effects of the same partnering strategy on different dimensions of IJV performance suggest that SMEs should be aware of the pros and cons of different partnering strategies for different organizational objectives and make the choice that helps to achieve the most important objective, whether it is longevity, profitability or another objective.

2. Introduction

Sooner or later, many firms choose to expand their geographic scope from domestic to foreign markets. There is an array of modes for entering international markets, such as exporting, licensing, non-equity strategic alliances, joint ventures and wholly owned subsidiaries, each of which has its own advantages and disadvantages (for a review, see [Anderson and Gatignon, 1986](#)). As an important means of international expansion, international joint ventures (IJVs) have been implemented with increasing frequency (e.g., [Osborn and Hagedoorn, 1997](#); [Hitt et al., 2000](#); [Dhanaraj and Beamish, 2004](#)). Within this general popularity of international joint ventures, a growing number of them involve small and medium enterprises ([Zahra et al., 2000](#)). Although there is a mounting body of research on the outcome of international joint ventures, the focus of prior studies tends to be on IJVs established by large firms with little attention to SMEs' IJVs (e.g., [Dussauge et al., 2000](#); [Hennart et al., 1998](#)). Given the significant differences between smaller and larger firms, the antecedents and outcomes of IJVs established by SMEs may well differ from those by large firms. Thus there is a need to examine IJV performance in the context of small and medium enterprises.

Within the array of choices made by small and medium enterprises that might affect the performance of their international joint ventures, this study focuses on the choice of IJV partners because partner selection is one of the first and most fundamental choices that a firm makes after deciding to use an IJV as an entry mode ([Hitt et al., 1995](#)). We explored the performance implications of SMEs' partnering strategies by bridging concepts and theories drawn from the entrepreneurship, strategy, and international business areas because our research question is at the intersection of these literatures. We discussed the deficiencies in resource endowments in the form of liabilities of foreignness, newness and smallness confronted by SMEs' international joint ventures. We then propose potential partnering strategies to overcome these three liabilities.

In our theorizing of partner selection, we integrate resource-based view theory with institutional theory to balance economic considerations with social considerations ([Lu, 2002](#)). We emphasize the resources that an IJV partner brings into the joint venture and how such resources could help alleviate resource deficiencies faced by the SMEs and their foreign subsidiaries in international expansion. We also differentiate partners' experience-based resources such as host country knowledge from size-based resources such as financial resources and reputation. We further highlight how social considerations among IJV partners could influence IJV performance.

We employed both IJV longevity and IJV profitability as performance measures to capture different dimensions of the performance construct. More importantly, we contend that the antecedents of improved IJV profitability might differ from those for IJV

longevity. We directly test such a contention by exploring the differential implications of partnering strategies on IJV profitability and IJV longevity. Finally, in our modeling of IJV longevity, we included profitability as a predictor of longevity to explicitly account for the fact that financial performance is often an antecedent of the exit decision. This kind of two-stage modeling of longevity presents advancement to prior studies which examined profitability and longevity as two independent outcomes (Delios and Beamish, 2001).

We implemented our investigation using a sample of 1117 international joint ventures established by 614 Japanese small and medium enterprises across 43 countries. We also conducted semi-structured interviews with 11 Japanese joint ventures in China to explore the mechanisms through which partnering strategies have effects on IJV performance. The SMEs and their largest Japanese partners in our sample differ dramatically in their sizes and resource bases. For example, the SMEs in our sample have an average of 220 employees and less than 2 years of operating experience in the host countries of the IJVs. In contrast, their large Japanese partners have an average of 5398 employees and on average, 84 years of operating experience in the host countries of the IJVs. The dramatic differences exemplify the potential benefits to SMEs by leveraging large firms' resources in their international expansion as well as the potential problems stemming from bargaining power differences in SME-large firm partnership. Such a sample provides an ideal setting for the test of our hypotheses.

Our findings contribute to the entrepreneurship, strategy and international business literatures by demonstrating differential performance implications of the same partnering strategy and the contrasting effects of partners' experience-based and size-based resources. Our theoretical framework also advances the theorizing of IJV performance by integrating resource-based view theory with institutional theory to provide more balanced considerations on IJV performance.

3. Partnering strategies and IJV performance

A joint venture is "an entity that is created when two or more firms pool a portion of their resources to create a separate jointly owned organization" (Barringer and Harrison, 2000). The increasing importance of joint ventures as an internationalization strategy has led to substantial research on the antecedents and outcomes of international joint ventures, especially among strategy and international business researchers. Consistent with the traditional focus of strategy and international business research on large, well-internationalized firms (McDougall and Oviatt, 1996), most of these empirical studies have focused on international joint ventures established by large firms to the exclusion of SMEs' international joint ventures. The empirical findings on the relationships between partnering strategies and IJV performance based on samples of international joint ventures established by large firms do not necessarily apply to IJVs established by small and medium enterprises because it has been well argued and documented that smaller businesses and larger businesses are different species (Shuman and Seeger, 1986).

Resource-based view of the firm emphasizes the importance of firms' resource endowments (Barney, 1991). Compared to large firms, small and medium enterprises have limited financial and managerial resources (Jarillo, 1989; Oviatt and McDougall, 1994).

Further, small and medium enterprises are usually owned and managed by founders, whereas large firms are managed by professionals (Shuman and Seeger, 1986). As a result, the decision-making in SMEs is highly centralized (Carrier, 1994). In a sample of 28 mid-Atlantic small and large electronic firms, Smith et al. (1988) identified that entrepreneurs/owners of SMEs are less comprehensive in their decision behavior as compared to large firms' professional managers. They have further demonstrated that such behaviors have a negative impact on SME performance. In a similar vein, we contend that the distinguishing characteristics of SMEs may well have an impact on the performance of their international joint ventures.

Further, most of the studies on IJV performance have tended to focus on IJV longevity (sometimes called survival), perhaps due to the difficulty in obtaining profitability information. Firm performance is a multidimensional construct and a strategy could well have differential effects on different dimensions of firm performance (Delios and Beamish, 2001). IJV longevity and profitability are two notable dimensions of IJV performance, and it is important to understand the differential influence that partnering strategies have on both.

In contrast to the abundance of research on the relationship between partnering strategies and IJV performance in the international business and strategic management literatures, researchers in the entrepreneurship area have paid sparse attention to international joint ventures, especially to the outcome of SMEs' international joint ventures (McDougall and Oviatt, 1996; Coviello and McAuley, 1999). Given the increasing importance of joint venture as an internationalization mode for small and medium enterprises, it is crucial to start to explore if and how partnering strategies influence IJV performance.

International joint ventures are especially important for small and medium enterprises in their internationalization process. By definition, small and medium enterprises have more constraints in resources and capabilities (Jarillo, 1989; Beamish, 1999) as compared to large firms. As a result, SMEs are subject to the liability of smallness (Aldrich and Auster, 1986) which is reflected in SMEs' difficulties in obtaining and securing critical resources such as capital and staff, and their vulnerability to environmental changes (Buckley, 1989). Such disadvantages impose constraints on the expansion of small and medium enterprises either in the domestic market or international markets (Zacharakis, 1997). More importantly, the liability of smallness can be hereditary and can adversely affect the future of SMEs' subsidiaries. As "children" of SME parents, SMEs' subsidiaries tend to be small in size and are subject to the same set of constraints in resources and capabilities that confront the SME parents. For SMEs' overseas subsidiaries, the liability of smallness inflates the liabilities of foreignness (Hymer, 1976) and newness (Stinchcombe, 1965).

Foreign subsidiaries of all firms, large or small, face the latter two liabilities, when the target markets are new to the parent firms and when they are greenfield investments that involve the establishment of new subsidiaries (instead of brownfield investments such as acquisitions) (Lu and Beamish, 2004). The liability of foreignness places foreign subsidiaries in a disadvantageous position in competition with local firms who are familiar with the local environment and have established good local connections. All overseas subsidiaries face this problem, but it can be a more severe problem for small and

medium enterprises because they are less experienced in international markets compared to large firms (Lu and Beamish, 2001).

The liability of newness is reflected in the series of operational challenges facing a start-up, such as financing, recruiting, procuring and marketing. More importantly, the liability of newness raises the issue of legitimacy which directly affects the solution to all the above operational challenges. Compared to incumbents, new entrants have to work hard to prove themselves in order to establish relationships with various stakeholders. The legitimizing process can be both expensive and time-consuming, substantially increasing the challenges faced by the new subsidiaries. This process can be more difficult for SMEs' new subsidiaries because they cannot leverage their SME parents' public awareness as can the new subsidiaries by large firms who are more well-known (Eisenhardt and Schoonhoven, 1990).

Taken together, SMEs' foreign subsidiaries face more resource constraints in undertaking international expansion than large firms' foreign subsidiaries. Such resource constraints are manifest in three liabilities which place small and medium enterprises in a disadvantageous position in competition with local firms and with subsidiaries established by larger firms. International joint venture can be an important means for small and medium enterprises to help their foreign subsidiaries overcome these three liabilities by having access to IJV partners' resources.

Resources of particular interest to SMEs in their international expansion are knowledge about the local markets, firm reputation and financial capital. IJV partners' knowledge about the local markets can help reduce the liability of foreignness confronted by SMEs' foreign subsidiaries (Delios and Henisz, 2000). IJV partners' knowledge about the local markets depends on the partners' experience in the local markets. IJV partners' reputation provides endorsement to SMEs' foreign subsidiaries and thus helps mitigate their liabilities of newness (Baum and Oliver, 1991; Stuart et al., 1999). IJV partners' financial capital can alleviate the financial constraints of SMEs' foreign subsidiaries and help reduce their liabilities of smallness (Hitt et al., 2000). IJV partners' reputation and financial capital are closely associated with the size of the partners. We discuss partners' host country knowledge, an experience-based resource, and partners' reputation and financial resources, two size-based resources and their performance implications to SMEs' international joint ventures in the following sections.

3.1. Partners' host country knowledge

As discussed earlier, knowledge about the host countries is a critical resource for the success of SMEs' foreign subsidiaries. It is possible for small and medium enterprises to acquire local knowledge and develop new organizational capabilities internally through incremental experience accumulation in new markets (Johanson and Vahlne, 1977). However, this learning-by-doing process takes time and can result in mistakes (Dierickx and Cool, 1989). Coupled with the vulnerability as a result of their small size, these mistakes can endanger the longevity of both SME's foreign subsidiaries and their SME parents (Beamish, 1999). By accessing an IJV partners' local knowledge base, an SME's foreign subsidiary can expedite its learning process and minimize mistakes.

A local (host country) partner represents a primary source of local knowledge as compared to home country partners (Yan and Gray, 1994). A local partner tends to have more detailed knowledge about various aspects of the host country environment, as compared to the other partner options. A local firm is familiar with the needs and tastes of the local consumers. It has information about local competitors. It also has local networks that can provide its international joint venture(s) with timely information on the changes in the local environment. In sum, an IJV with a local partner can provide an immediate alleviation of SMEs' local knowledge deficiencies and help overcome its liability of foreignness (Hymer, 1976). The reduction in the disadvantages as compared to local firms should help improve a foreign subsidiary's competitive position in the local market and contribute to improved profitability (Beamish and Banks, 1987; Makino and Delios, 1996).

Prior research has found evidence that there is a positive relationship between the use of a local partner and the performance of international joint ventures (Beamish, 1985; Blodgett, 1992; Makino and Delios, 1996). Although the setting of prior studies employed samples of large firms, we expect the same relationship to exist in a sample of IJVs established by small and medium enterprises because SMEs usually have less international experience and are subject to more severe local knowledge deficiencies when they expand across borders. For example, one of the managers of a Japanese SME joint venture in China said that: "(They) used their relationship with governments to make sure that our business license was issued in time. (They) recruited capable local staff, handled all import and export procedures, helped market the products through their distribution channels. Without local partners, we could not have achieved what we did." Consistent with the findings of our field work and prior studies, we hypothesize:

Hypothesis 1a. The use of local partner(s) is positively associated with the profitability of SMEs' IJVs.

While a local partner can contribute to superior IJV performance through the reduction in the liability of foreignness, its value can depreciate over the life cycle of the international joint venture. As foreign partners accumulate experience in the local environment, they become less dependent on local partners for local knowledge and may even find that the role of local partner is redundant (Makino and Delios, 1996). As the dependence on a local partner's local knowledge decreases, a foreign partner's bargaining power over the local partner increases. The change in the balance of the bargaining power between local and foreign partners can lead to IJV instability or even IJV dissolution (Inkpen and Beamish, 1997). Given this potentially larger instability of international joint ventures with local partners, we expect that IJVs with local partners can have higher exit rates than IJVs between home country partners.

Hypothesis 1b. The use of local partner(s) is negatively associated with the longevity of SMEs' IJVs.

Given SMEs' accumulation of host country knowledge as the major underlying reason for this instability, we also expect SMEs' host country knowledge to strengthen the negative relationship between the use of local partners and the longevity of their international joint ventures.

Hypothesis 1c. SMEs' host country knowledge strengthens the negative effects that the use of local partner(s) has on the longevity of SMEs' IJVs.

Another source of host country knowledge is home country partners. Although home country partners are not "born local" in the same way as local firms are, they can nonetheless have good knowledge about the local environment through their operation in IJVs' host countries. In this experiential process, foreign firms develop general knowledge about the political, social, economic and cultural aspects of the investment locations and specific knowledge about local business practices and local networks (Johanson and Vahlne, 1977). This experience-based local knowledge from home country partners could be as effective as the local knowledge from local partners in helping SMEs' international joint ventures to alleviate their liability of foreignness. The change in the source of local knowledge (from local partner to home country partners) should not change the positive effects of local knowledge on IJV performance. The reduction in the disadvantages in competition with local firms and other experienced foreign subsidiaries should confer competitive advantages to SMEs' international joint ventures and lead to higher profitability.

Hypothesis 2a. The host country experience of home country partner(s) is positively associated with the profitability of SMEs' IJVs.

On the other hand, an international joint venture can be considered as a vehicle for investing firms for learning what the other partner knows (Hamel, 1991; Parkhe, 1991). As long as this learning goal is not satisfied, JV partners have a need for each other, and the incentive to work together and keep the international joint venture in operation. From this perspective, the more a partner has to learn from its international joint venture partner, the longer it takes to acquire the knowledge, the slower the change in bargaining power due to the acquisition of knowledge, and the more stable an international joint venture. As such, the absence of experience in IJVs' host country presents more incentives for learning from the other partner in the joint operation of the IJV. The strong learning incentive should promote IJV longevity.

Hypothesis 2b. The host country experience of home country partner(s) is negatively associated with the longevity of SMEs' IJVs.

2.2. Partner size

The size of the partnering firms is another important consideration, especially for small and medium enterprises. In addition to the liability of foreignness which could be overcome through partnering with a local partner and/or home country partner with local experience, SMEs' international joint ventures are subject to liabilities of smallness and newness. Given the resource constraints of their SME parents, SME subsidiaries tend to be smaller in size, as compared to subsidiaries established by large firms. Being small, they do not have as many resources to withstand mistakes or losses and are vulnerable to environmental selection. The liability of smallness is reflected in problems of raising capital, recruiting and retaining staff, and handling the administrative costs of compliance

with government regulations (Aldrich and Auster, 1986). The liability of smallness has been found to be closely and positively related to organizational mortality rates (Freeman et al., 1983; Singh et al., 1986).

As with all new ventures, international joint ventures face a liability of newness (Stinchcombe, 1965) which is rooted in the uncertainty about the viability of a new venture. Compared to international joint ventures established by large firms, SMEs' international joint ventures are likely to be newer to the local community because small and medium enterprises have lower levels of public awareness than large firms. This enhanced newness of SMEs' subsidiaries makes it more difficult to have access to local resources and more time-consuming to develop local business networks in investment sites.

Partnering with large firms could help alleviate these two liabilities. There are a number of contributions that large firms can bring to SMEs' foreign subsidiaries. Two of the most critical are resources and reputation. By definition, large firms are more resource-rich than small and medium enterprises. Partnering with large firms can alleviate SMEs' resource constraints in the establishment of their foreign subsidiaries. With the resource backup from large firms, SMEs' foreign subsidiaries could achieve full operation and growth faster than otherwise would be possible with the resource constraints of SMEs. As the international joint ventures grow, they accumulate greater managerial and financial resources themselves and become less vulnerable. The situation is likely to enhance IJV longevity.

In addition, partnering with large firms also allows small and medium enterprises to leverage the reputations of large firms to quickly establish the legitimacy of their international joint ventures in host countries. Institutional theory emphasizes institutional environments which include cognitive and sociological elements, such as shared norms, standards, and expectations (DiMaggio and Powell, 1991; Scott, 1995). This institutional environment is an underlying driving force behind organizational activities because of an organization's desire for legitimacy (Martinez and Dacin, 1999). Large size tends to legitimate organizations, to the extent that large size is interpreted by external stakeholders as an outcome of an organization's prior success (Baum and Oliver, 1991). Business connections with large firms, either in the form of one-term business transactions or long-term partnership, are likely to enhance the legitimacy of smaller firms (Barringer and Harrison, 2000). In a similar vein, with large firms as a partner in the international joint venture, SMEs' international joint ventures can shorten the time it takes to establish legitimacy in the relevant industries and host countries. With the establishment of their legitimacy and enhanced visibility and image, it would be easier for SMEs' international joint ventures to obtain financial and human resources in local markets and develop local networks with suppliers and buyers (Stuart et al., 1999). Prior research has demonstrated that inter-organizational endorsement helps new organizations to acquire legitimacy which in turn reduces their mortality rate (Baum and Oliver, 1991).

In addition to the above direct and indirect contributions to IJV longevity, large partners have resources and incentives to keep their subsidiaries operating. With "deep pockets", large firms can better sustain losses from some of their subsidiaries. Large firms may also have a longer-term view towards foreign investments, allowing them to keep their

subsidiaries operating a bit longer to assess their viability. Further, social considerations may also permit large firms to maintain their subsidiaries, even if they are incurring losses. From an institutional perspective, large firms tend to attract disproportionate attention from the public. Large firms are arguably more concerned than small and medium enterprises about the downside effect on their reputation associated with the dissolution of their international joint ventures. To maintain favorable public image, large firms may hesitate to terminate unprofitable subsidiaries. All factors, from either economic or social perspectives, point to an increase in the longevity of international joint ventures with large partners.

Hypothesis 3a. The size of home country partner(s) is positively associated with the longevity of SMEs' IJVs.

Even with the various benefits associated with partnering with large firms, it has been well documented that partnering with large firms can be detrimental to small and medium enterprises. There is a general concern with the compatibility between the management systems and styles of larger versus smaller firms in the joint management of their foreign subsidiaries (Park and Ungson, 1997). A more fundamental concern from the perspective of small and medium enterprises is the differences in bargaining power stemming from the significant differences in firm sizes (Alvarez and Barney, 2001). The dependence of SMEs' international joint ventures on large partners for resources and legitimacy gives the large partners bargaining power over the SME parents and places them in a position to potentially exploit the international joint ventures or alliances for their own economic gains. Large firms have sometimes appeared to form predatory alliances with SMEs. For example, in Alvarez and Barney's study of 218 alliances between large and entrepreneurial firms in American high-technology industries, almost 80% of entrepreneurial firms experienced exploitation from large partners in their alliances (Alvarez and Barney, 2001).

From an institutional perspective, profitability is less visible than survival because it is difficult for the public to obtain financial information on unlisted firms or on particular subsidiaries. Therefore, in terms of their public image, large firms are more concerned about the survival (rather than profitability) of their subsidiaries. As such, the social considerations around the survival of SMEs' IJVs do not apply to the same extent when considering their profitability.

The exploitation of large partners can take the form of withdrawing or not contributing the crucial resources to alliances with SMEs (Alvarez and Barney, 2001). More often, large firms make unreasonable demands or impose unfair contractual or non-contractual terms in business transactions on alliances with SMEs (Osborn and Baughn, 1990). In our field work, a joint venture established by a Japanese SME in the shipping industry complained that its larger partner, a *sogo shosha*, expected the joint venture to give priority to the shipment of all the subsidiaries established by the *sogo shosha*. In addition, there were expectations about higher service standard at lower prices for the *sogo shosha*'s shipments. This arrangement limited the joint venture's choices of customers and the preferential pricing cut into its profit margins. The vulnerability of SMEs to exploitation and the subsequent acceptance of unfair terms could hurt the profitability of their international joint ventures.

Hypothesis 3b. The size of home country partner(s) is negatively associated with the profitability of SMEs' IJVs.

Although large firms are in a position to exploit SME partners in their joint ventures, the extent that exploitation by large partners happens depends on the level of equity ownership of large partners in the IJVs. It has long been argued that a firm's level of equity ownership in a venture is reflective of its commitment to the investment (Anderson and Gatignon, 1986). To some extent, equity positions are like "hostages" or "collaterals" which can help mitigate opportunism in joint ventures (Beamish, 1985; Mjoen and Tallman, 1997; Dhanaraj and Beamish, 2004). These findings in the IJV literature on the role of equity position in IJVs are consistent with those from our field work: the exploitative situation described by SME partners usually appears when the large partner takes a small stake in the joint venture. Therefore, we expect that as large partners' equity levels in IJVs increase, there is less incentive for them to exploit the IJVs and their smaller partners. Therefore, we hypothesize:

Hypothesis 3c. The equity ownership of home country partner(s) weakens the negative effects that the size of home country partner(s) has on the profitability of SMEs' IJVs.

The contrasting effects of two resources, experienced-based resources and size-based resources, contributed by IJV partners, on the profitability and longevity of SMEs' IJVs are reflective of the differences in the development of these two resources. SMEs can have access to and leverage larger partners' size-related resources such as financial resources and reputation. But they cannot possess such resources in the joint operation of IJVs and become comparable in size to their larger partners, at least not in the near future. In contrast, experience is easier to develop. In the joint establishment and operation of joint ventures, SMEs can learn local knowledge from their partners and from their own experience in the local environment. As SMEs accumulate their own host country knowledge, their JV partners may become redundant at least in terms of host country knowledge. As such, IJV partners' local knowledge contributes to IJV profitability but may hamper IJV longevity given the diminishing value of JV partners' host country knowledge as SMEs acquire it themselves. In contrast, IJV partners' size-based resources are not a potentially destabilizing factor because SMEs cannot really acquire their partners' size-related resources and are more likely to be dependent on such resources for a long period of time. However, SMEs' dependency on larger firms' size-related resources may depress IJV profitability because larger firms are in a position to take advantage of this dependency and impose unfavorable terms on SMEs in the design and management of their JVs.

4. Methodology

4.1. Sample and data sources

For the implementation of our investigation, we collected data on Japanese small and medium enterprises and their international joint ventures worldwide. We used two

sources for the corporate-level information on Japanese small and medium enterprises. For listed small and medium enterprises, the main source of Japanese parent company information is the *Nikkei NEEDS* tapes, an electronic database compiled by Nihon Keizai Shinbun-sha, one of the largest compilers and publishers of statistical and corporate information in Japan. This database provides financial information on all Japanese firms listed on the Tokyo stock exchange. The *Nikkei NEEDS* tapes report detailed firm-level information compiled from the firm's balance sheet, income statement and includes other supplementary data (e.g., number of employees). Annual information can be traced since 1964 from this database. For this study, we used information up to the 2000 edition which provided information on more than 3000 publicly listed Japanese firms. Where required, additional parent company information was gathered from the *Analysts' Guide*, a publication by Daiwa Institute of Research, the *GlobalVantage* database and various editions of the *Japan Company Handbook*, all of which have a coverage of parent firms similar to that in the *Nikkei NEEDS* tapes. For unlisted small and medium enterprises, we consulted three editions (1996, 1998 and 2000) of Japanese private firm directory. Each directory provided 3-year information on Japanese unlisted firms in terms of products, number of employees, sales and profits, etc.

The source of information for the foreign direct investment of Japanese firms was *Kaigai Shinshutsu Kigyō Souran, Kuni-Betsu*. This source is published annually by Toyo Keizai Inc., a large Japanese compiler and publisher of business-level, statistical and economic information. The data reported in *Kaigai Shinshutsu Kigyō Souran* was based on responses to questionnaires sent to all firms listed on Japanese stock exchanges, as well as to major unlisted firms. Researchers at Toyo Keizai used press releases, annual reports and telephone interviews to supplement the questionnaire data and to increase the comprehensiveness of the information reported in *Kaigai Shinshutsu Kigyō Souran*. The coverage of *Kaigai Shinshutsu Kigyō Souran* is close to the population of foreign subsidiaries for Japanese firms that responded to the survey (Beamish et al., 1997). In terms of the data in *Kaigai Shinshutsu Kigyō Souran*, it provides information on the date of establishment, the entry mode, the equity position and identity of the subsidiary's parents. It also reports the subsidiary's industry, its equity capital, sales, and total employment, the identity of joint venture partners, local and expatriate employment levels and subsidiary performance. For this study, we coded all the information about foreign subsidiaries established by Japanese SMEs' from the 1986, 1989, 1992, 1994, 1997, 1999 and 2001 editions.

Consistent with other studies on small- and medium-sized firms in the entrepreneurship literature (Baird et al., 1994; Beamish, 1999; Wolff and Pett, 2000; Lu and Beamish, 2001), this study employs the definition of small and medium enterprises provided by the American Small Business Administration (SBA): stand-alone enterprises with fewer than 500 employees. Further, in line with prior studies on joint ventures (e.g., Hennart et al., 1998; Delios and Beamish, 1999), we include a firm as a parent of the international joint venture if it has more than 5% and less than 95% equity ownership in the investment. Combining these two criteria, we included an international joint venture in the sample if at least one of its parents is an SME who has a minimum of 5% and maximum of 95% equity of the investment.

4.2. Variables

4.2.1. Dependent variables

Given that performance is a complex multidimensional construct, previous researchers (Venkatraman and Ramanujam, 1986) have argued convincingly that studies should include multiple, disparate performance measures. In this study, we used two measures, longevity and profitability, to capture the different dimensions of IJV performance.

We identified exiting subsidiaries by comparing preceding editions of *Kaigai Shinshutsu Kigyō Souran* with later editions. The earliest edition we used was 1986 and the latest edition was 2001. Exits were coded as one, and surviving international joint ventures were coded as zero. The duration of the international joint venture, to its time of exit or to the year 2001, was computed by the number of years from foundation to exit, or to 2001. We backtracked the exact exit year by consulting consecutive editions of *Kaigai Shinshutsu Kigyō Souran* from 1986 to 2001. The exit year was the year that the joint venture was de-listed in the database. Although one could not equate exit completely with failure, one could expect that an IJV would remain in operation as long as it represented the most appropriate organization mode (Inkpen and Beamish, 1997). Empirical evidence from prior studies also suggests that longevity correlates positively with financial and satisfaction measures of performance (Geringer and Hébert, 1991).

The measure of JV profitability was based on a managerial assessment of profitability. Performance was measured by asking the top Japanese manager in each subsidiary to specify performance for the unit on a three-point scale, representing “Loss”, “Break-even” and “Gain”. This study uses this performance measure because the validity of similar perceptual measures of performance is well supported in the academic literature. For example, perceptual performance measures have been shown to be highly correlated with objective, accounting-based measures (Geringer and Hébert, 1991). Further, prior studies on the performance of Japanese subsidiaries have verified and confirmed the validity and reliability of this measure in Japanese empirical settings (Isobe et al., 2000; Delios and Beamish, 2001).

4.2.2. Independent variables

4.2.2.1. Local partner. Our data source, *Kaigai Shinshutsu Kigyō Souran*, indicated there were 705 non-Japanese partners. We checked the identity of each of these 705 non-Japanese partners and found that 21 of them were third country partners and the rest were local partners. The proportion of third country partners is consistent with that reported by Makino and Beamish (1998). We deleted the 21 IJVs with third country partners as our theoretical framework focuses on the use of host country partners and home country partners. We coded the use of local partners (with or without the participation of Japanese partners) as one.

4.2.2.2. Japanese partners' host country experience. We computed Japanese partners' host country experience as the host country experience of the Japanese partner who had the most experience prior to the focal entry in the same host country of the SMEs' international joint ventures. Host country experience is the number of years in which a

firm operated a subsidiary in a particular host country. This measure was computed from information reported in various editions of *Kaigai Shinshutsu Kigyō Souran*. We focused on the Japanese partner with the most host country experience because SMEs should potentially have access to the maximum (rather than the average) resources of their Japanese partners.

4.2.2.3. Japanese partners' firm size. For the same reason as the focus on the Japanese partners with the most host country experience, we defined Japanese partners' firm size as the number of employees of the largest Japanese partners. This measure was derived from the *Nikkei Needs* database.

4.2.2.4. Japanese partners' equity ownership level. We computed Japanese partners' equity ownership level as the percent equity ownership by the largest Japanese partner. This measure was obtained from various editions of *Kaigai Shinshutsu Kigyō Souran*.

4.2.2.5. Control variables. We included three measures to account for major factors at the international joint venture level that could affect IJV performance. They are JV size (measured as total number of employees), SME-IJV product relatedness (coded one if SMEs and their IJVs are in the same product category as defined by 2-digit SIC codes) and JV location (measured as cultural distance between home country and host countries). The cultural distance measure was computed from Hofstede (1980) measures using the methodology outlined in Kogut and Singh (1988).

We next calculated three measures (corresponding to those for Japanese partners as independent variables) to control for factors at the focal SME parent level. We computed the host country experience of the SME parent prior to the focal entry. We computed the size of the SME as the number of employees. We then computed percent equity ownership by SMEs. In addition, we controlled for the ownership type of the SMEs as we have both private and listed firms in our sample. We coded one when an SME is a publicly listed firm. Our final control was a set of industry dummies based on 2-digit industry codes. For the profitability model, we added an extra control variable of subsidiary age defined as the number of years that an IJV operates in a host country. For the longevity model, we added profitability as the extra control variable as profitability is an important consideration in the decision to keep or terminate an IJV.

After matching the parent information with information on foreign direct investments and deleting cases with missing values, we obtained a sample comprising 1117 international joint ventures established by 614 Japanese small and medium enterprises in 43 countries worldwide. 27% of the IJVs in our sample had more than two partners and the maximum number of partners in one international joint venture in our sample is six. For hypotheses regarding home country partners, the sample size was reduced to 631 international joint ventures and further to 522 international joint ventures because of missing information on firm size of some of the partners.

We employed ordered logit analysis to examine the hypotheses about IJV profitability. Ordered logit models are the appropriate procedure when the dependent variable has ordinal properties but is not ratio scaled (Amemiya, 1981). For the test of the hypotheses related to IJV longevity, we used Cox's proportional hazard model

Table 1
Descriptive statistics and correlations

Variable and definition	1117 IJVs		522 IJVs		1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16
	Mean	S.D.	Mean	S.D.																
1. IJV Exit	0.18	0.39	0.13	0.34		−0.15	−0.03	0.06	−0.09	−0.07	0.08	0.00	0.01	0.05	0.01	0.03	0.00	−0.02	0.06	−0.02
2. Profitability	2.39	0.78	2.36	0.81	−0.06		0.21	−0.02	0.02	−0.04	−0.09	0.00	−0.08	0.01	0.05	0.03	0.07	−0.01	−0.08	0.04
3. IJV age	10.20	7.42	10.60	7.59	0.00	0.18		0.10	−0.09	−0.06	0.02	−0.14	−0.12	0.06	−0.01	0.06	−0.24	0.03	−0.19	0.11
4. IJV size	160	524	185	698	0.03	0.03	0.09		−0.03	−0.05	−0.04	−0.02	−0.02	−0.07	0.10	−0.01	0.04	−0.08	−0.04	0.33
5. IJV location (culture distance)	2.93	0.77	2.97	0.76	−0.02	0.01	−0.12	−0.02		0.09	−0.01	0.05	−0.02	−0.09	−0.07	−0.13	−0.01	0.03	−0.09	−0.05
6. SMEs' equity ownership in IJVs	44.94	23.76	38.30	24.75	−0.02	−0.03	−0.06	−0.06	0.01		0.16	0.13	−0.08	0.15	−0.38	0.03	−0.02	−0.39	0.07	−0.05
7. SMEs' type (listed)	0.19	0.40	0.17	0.37	0.07	−0.08	−0.02	−0.03	−0.02	0.12		0.13	−0.01	0.37	−0.04	0.00	−0.01	−0.08	0.08	0.02
8. SME-IJV relatedness	0.30	0.46	0.21	0.41	0.00	0.03	−0.14	−0.02	0.10	0.10	0.11		0.16	0.14	−0.01	−0.06	0.07	−0.12	0.03	0.01
9. SMEs' host country experience	1.79	6.21	1.54	5.72	0.01	0.00	−0.13	−0.03	−0.02	−0.04	0.00	0.11		−0.11	−0.07	−0.08	−0.01	0.09	0.03	−0.07
10. SMEs' size	236	145	220	141	0.05	−0.02	−0.03	−0.08	−0.08	0.13	0.38	0.14	−0.08		0.05	0.08	0.09	−0.14	0.08	0.03
11. Local partner	0.62	0.49	0.49	0.50	0.04	0.06	−0.02	0.05	−0.07	−0.21	−0.01	0.04	−0.05	0.07		0.14	0.09	−0.38	−0.14	0.08
12. Japanese partners' type (listed)			0.66	0.48													0.20	−0.14	0.08	0.15
13. Japanese partners—IJV relatedness			0.67	0.47														−0.16	0.20	0.28
14. Japanese partners' equity ownership in IJVs			32.21	22.55															−0.11	−0.13
15. Japanese partners' host country experience			84	257																0.15
16. Japanese partners' size			5398	6966																

(1) All descriptive statistics reported for non-transformed values.

(2) Numbers in upper part of correlation matrix for IJVs with Japanese partners. Numbers in lower part of correlation matrix for all IJVs.

(3) Significant at the 0.05 level (two-tailed test) when Pearson correlations >0.086 or <-0.086 for upper part of correlation matrix and >0.058 or <-0.058 for lower part of correlation matrix.

Table 2
Regression on Performance of Japanese SMEs' IJVs^{a,b}

Variable	Exit=1					3=Profit; 2=Break-even; 1=Loss				
	All IJVs (<i>N</i> =1117, 206 exits)			IJVs with Japanese partners (<i>N</i> =522, 70 exits)		All IJVs (<i>N</i> =1117)		IJVs with Japanese partners (<i>N</i> =522)		
	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6	Model 7	Model 8	Model 9	Model 10
1. Loss	2.27*** (0.40)	2.42*** (0.44)	2.44*** (0.44)	4.58*** (1.30)	4.58*** (1.31)					
2. Break-even	1.22 (0.22)	1.23 (0.22)	1.25 (0.23)	1.18 (0.43)	1.16 (0.43)					
3. IJV age ^c						0.78*** (0.10)	0.79*** (0.10)	0.99*** (0.16)	1.05*** (0.17)	1.06*** (0.17)
4. IJV size ^c	1.07 (0.07)	1.07 (0.07)	1.08 (0.07)	0.95 (0.09)	0.95 (0.09)	−0.01 (0.05)	−0.01 (0.05)	0.07 (0.07)	0.07 (0.07)	0.07 (0.07)
5. IJV location	1.16 ⁺ (0.10)	1.17 ⁺ (0.10)	1.17 ⁺ (0.10)	0.94 (0.14)	0.90 (0.14)	0.09 (0.08)	0.10 (0.08)	0.17 (0.13)	0.17 (0.13)	0.17 (0.13)
6. SMEs' equity ownership in IJVs	1.00 (0.01)	1.00 (0.01)	1.00 (0.01)	0.99 (0.01)	0.99 (0.01)	−0.01 (0.01)	−0.01 (0.01)	−0.01 (0.01)	−0.01 (0.01)	−0.01 (0.01)
7. SMEs' type (listed)	1.14 (0.21)	1.16 (0.22)	1.16 (0.22)	1.29 (0.41)	1.53 (0.49)	−0.44** (0.16)	−0.43** (0.16)	−0.53* (0.25)	−0.53* (0.26)	−0.55* (0.26)
8. SME-IJV relatedness (2-digit SIC codes)	1.26 (0.21)	1.19 (0.20)	1.20 (0.20)	1.52 (0.52)	1.54 (0.52)	0.34* (0.14)	0.32* (0.14)	0.32 (0.24)	0.34 (0.24)	0.37 (0.24)
9. SMEs' host country experience ^c	1.22* (0.11)	1.25* (0.11)	0.98 (0.16)	1.10 (0.20)	1.04 (0.19)	0.05 (0.07)	0.05 (0.07)	−0.04 (0.11)	−0.05 (0.11)	−0.02 (0.12)

10. SMEs' size ^c	1.19*	1.19*	1.20*	1.17	1.02	0.08	0.07	0.14	0.14	0.14
	(0.10)	(0.10)	(0.10)	(0.16)	(0.15)	(0.07)	(0.07)	(0.11)	(0.11)	(0.11)
11. Local partner		1.50*	1.32	1.05	1.06		0.21 ⁺	0.27	0.28	0.30
		(0.25)	(0.23)	(0.35)	(0.35)		(0.13)	(0.26)	(0.26)	(0.26)
12. Japanese partners' equity ownership in IJVs				1.00	1.00			0.01	0.01	−0.08*
				(0.01)	(0.01)			(0.01)	(0.01)	(0.03)
13. Japanese partners' type (listed)				0.94	1.12			−0.15	−0.11	−0.11
				(0.28)	(0.37)			(0.20)	(0.21)	(0.21)
14. Japanese partners—IJV relatedness (2-digit SIC codes)				2.06*	2.36**			0.64**	0.68**	0.72**
				(0.60)	(0.77)			(0.21)	(0.23)	(0.24)
15. Japanese partners' host country experience ^c					1.24**				0.05	0.05
					(0.10)				(0.06)	(0.06)
16. Japanese partners' size ^c					0.67**				−0.12	−0.43**
					(0.09)				(0.10)	(0.16)
17. SMEs' host country experience ^c × Local partner			1.45*							
			(0.27)							
18. Japanese partners' equity ownership in IJVs × Japanese partners' size ^c										0.02**
										(0.01)
Log-likelihood	−1173.07	−1169.87	−1167.76	−333.05	326.78	−1044.12	−1042.75	−475.69	−474.85	−471.33
Model chi-square	57.09**	63.47**	67.70**	48.51**	61.06**	84.07*	86.81*	68.30*	69.99*	77.03*
Incremental chi-square		6.38*	4.23*		12.55**		2.74 ⁺		1.69	7.04**

*** $p < 0.001$; ** $p < 0.01$; * $p < 0.05$; ⁺ $p < 0.10$; all two-tailed tests.

^a Fixed effects for 2-digit SIC industries of entry were included in the models, but are not reported in the table.

^b Cell entries are unstandardized coefficient estimates. Numbers in parentheses are standard errors.

^c Logarithmic transformation.

(Cox and Oakes, 1984). This model estimates the influence of explanatory variables (or covariates) on the hazard of exit without specifying a parametric form for the precise time to failure. Instead, it ranks ventures in terms of the sequence of exit and maximizes the partial likelihood that the i th venture should exit conditional on the characteristics of the other ventures at risk at the time of exit. By incorporating the age distribution directly into the estimation, Cox regression procedure corrects the problems of censored data and aging effects on IJV dissolution and brings the exit rate closer to failure rate.

5. Results

Table 1 presents the descriptive statistics and a correlation matrix for the study's variables. As shown in Table 1, there were significant firm-specific differences between SMEs and their largest Japanese partners. For example, the average number of employees was 220 for the SMEs and 5398 for their largest Japanese partners. In addition, the majority of the SME parents was private (83%), had limited operating experience (<2 years) in their IJVs' host countries and in IJVs' industries (21% are related). In contrast, most of their largest Japanese partners were listed firms (66%) and had much more operating experience (>84 years) in the IJVs' host countries and in IJVs' industries (67% are related). These firm-specific differences by size are consistent with our discussions on the differences between SMEs and large firms.

The descriptive statistics also shows that the average exit rate was 0.18 and the average profitability was 2.39 in our full sample of SMEs' joint ventures. To put the performance of SMEs' joint ventures in perspective, we compared the performance of the SMEs' joint ventures with their wholly owned subsidiaries. We identified 1102 wholly owned subsidiaries established by Japanese small- and medium-sized companies. These wholly owned subsidiaries had an exit rate of 0.24 and an average profitability of 2.30. The significantly higher profitability ($p < 0.05$) and longevity ($p < 0.01$) of SMEs' joint ventures suggest that joint venture is an effective organization form for SMEs' foreign expansion.

We tested our three hypotheses using two sets of five regressions: one for profitability and the other for longevity. The results of these regressions are displayed in Table 2. All models were significant. For the interpretation of the results, a hazard ratio lower than one suggests an increase in the longevity of international joint ventures for Models 1–5 while a positive sign indicates an improvement in IJV profitability for Models 6–10.

Models 1 and 6 are the base-line models which only includes all the control variables and the set of industry dummies. In Model 1, the base-line model for longevity, IJV's financial losses increased its likelihood of exit, as did SMEs' firm size (measured as number of employees) and SMEs' experience in the IJVs' host country. In Model 6, the base-line model for profitability, IJV age had a significant positive effect on performance as expected. At the same time, IJV profitability benefits from the product relatedness between SMEs and their IJVs (2-digit SIC codes) but suffers when the SME is a listed firm.

Models 2 and 7 tested Hypotheses 1a and 1b which predict that the use of a local partner is positively related to IJV profitability but negatively related to IJV longevity. Consistent with the prediction in Hypothesis 1a, the use of a local partner had a positive relationship to IJV profitability. However, this positive effect is only significant at the level of $p < 0.10$. At the same time, the use of local partner had a negative and significant influence on the longevity of international joint ventures. Hypothesis 1b is supported.

Hypothesis 1c explores the underlying reason for the relationship identified in Hypothesis 1b and identifies SMEs' host country knowledge as a contributing factor to the negative role of local partner in IJV longevity. Model 3 tested this hypothesis by entering the interaction term between SMEs' host country knowledge and the use of local partner. The change in the chi-square suggests that the inclusion of this interaction term significantly improves the model fit. As predicted in Hypothesis 1c, the coefficient estimation of this interaction term is significant and has a value greater than one, suggesting that SMEs' accumulation of host country knowledge strengthens the negative effects of a local partner on IJV longevity.

Hypotheses 2a, 2b, 3a and 3b make predictions about the resource contributions of home country partners. Models 5 and 9 tested these hypotheses by entering Japanese partners' firm size and host country knowledge while including the same set of control variables for the international joint ventures and for the SMEs. Models 4 and 8 are the base-line models for Models 5 and 9, respectively. In Model 5, Japanese partner's host country experience significantly increases the exit rate of international joint ventures, supporting Hypothesis 2b. Japanese partner size has significant and positive impact on the longevity of international joint ventures, as predicted by Hypothesis 3a. In Model 9, the coefficients for both Japanese partners' firm size and host country experience signed as predicted in Hypotheses 2a and 3b. However, they are not statistically significant, providing little support for Hypothesis 2a and 3b.

Finally, Model 10 tested Hypothesis 3c which specifies that Japanese partners' size has a negative effect on SMEs' IJVs when Japanese partners have low equity positions in the IJVs. As shown in the incremental chi-square statistics, the inclusion of the interaction term between the levels of Japanese partners' equity ownership and Japanese partners' size significantly improved the model fit. Japanese partners' size is significant and signed negative, while the interaction term is significant and signed positive, indicating the negative effects of Japanese partners' size on the profitability of SMEs' IJVs are reduced as the levels of these Japanese partners' equity ownership go up. Hypothesis 3c is strongly supported.

6. Discussion

In this paper, we attempted to examine the effectiveness of international joint venture, an important internationalization strategy for small and medium enterprises. To that end, we explored the differential effects that two types of resources contributed by IJV partners, experience-based and firm size-based resources, had on two dimensions of IJV performance, profitability and longevity, in a sample of international joint ventures established by small- and medium-sized Japanese firms. [Table 3](#) summarizes the hypotheses and the results of the empirical tests.

Table 3
Summary of hypotheses and results

Variables		Hypothesized relationship to IJV performance		Model	Results
H1a	Use of local partner	(+)	Profitability	7	(+)
H1b	Use of local partner	(−)	Longevity	2	(−)
H1c	Use of local partner x Japanese SMEs' experience in IJV's host country	(−)	Longevity	3	(−)
H2a	Japanese partners' experience in IJV's host country	(+)	Profitability	9	Not significant
H2b	Japanese partners' experience in IJV's host country	(−)	Longevity	5	(−)
H3a	Japanese partner size	(+)	Longevity	5	(+)
H3b	Japanese partner size	(−)	Profitability	9	Not significant
H3c	Japanese partner size × Japanese partners' equity ownership in IJVs	(+)	Profitability	10	(+)

We found that the use of a local partner had positive impacts on the profitability of SMEs' IJVs. Although the significance level of this positive effect is only significant at $p < 0.10$ level, it provides some support to our Hypothesis 1a. Our findings are consistent with that of prior large-firm studies (e.g., [Makino and Delios, 1996](#); [Makino and Beamish, 1998](#)). Our results further confirm the finding of positive impact that the use of local partner has on the corporate performance of small and medium enterprises ([Lu and Beamish, 2001](#)). Japanese partners' host country knowledge also had positive effects on IJV profitability. However, such positive effects were not significant. The differences in the effects of host country knowledge between local partners and Japanese partners suggest that while both local partners and home country partners are viable sources of local knowledge, for small and medium enterprises, local partners seem to be a more effective choice than home country partners for access to local knowledge. The positive effects that a local partner has on an IJV's profitability highlight the importance of local knowledge and the fact that a local partner presents a primary source of local knowledge.

In contrast to its weak, yet consistently positive effects on IJV profitability, host country knowledge, either from local partners or Japanese partners, was found to have a strong negative effect on an IJV's longevity. We further tested the seemingly contradictory effects of local partners and found that SMEs' host country knowledge accumulation contributed to the negative relationship between the use of local partners and IJV longevity. Consistent with the findings in prior studies ([Makino and Beamish, 1998](#)), our results support the argument that partner bargaining power is a contributing factor to IJV instability ([Inkpen and Beamish, 1997](#)). Our findings also illustrate the instability of many international joint ventures. One way to reduce this instability is for the partners to contribute a diverse and continuing set of resources and knowledge, rather than the one-time contribution of host country knowledge, to their international joint ventures. In this way, the dependency between partners is enhanced, the partner bargaining power is less likely to change dramatically, and the IJVs will become more stable.

Further, we explored whether and how partners' size-related resources had an impact on the performance of SMEs' IJVs. We found that Japanese partners' size had a negative effect on the profitability of SMEs' IJVs. However, such negative effect is not significant. In contrast, Japanese partners' size had a significant and positive effect on the longevity of SMEs' IJVs. We further found that Japanese partners' size negatively affects the profitability SMEs' IJVs when Japanese partners assumed low equity ownership of the IJVs. Our findings indicate that given the dependency of the small and medium enterprises on their larger partners' size-based resources, larger firms are in a position to leverage their strong bargaining position and exploit the small and medium enterprises and their international joint ventures. One way to reduce larger partners' incentives of exploitation is to increase their equity ownership in the IJVs. The positive effect of large partners on the longevity of SMEs' IJVs indicates the importance of access to resources and the endorsement effect gained from partnering with large partners. More importantly, it shows that the more difficult it is to replicate the partners' resources, the more stable the IJVs. Compared to host country knowledge, an experience-based resource, size-based resources such as financial resources and reputation are often path-dependent and hence take much longer time to develop. SMEs can acquire much more easily their partners' host country knowledge than their size-related resources. Therefore, the contribution of size-related resources leads to IJV longevity while the contribution of host country knowledge increases the exit rates of IJVs. The contrasting effects of host country knowledge and size-related resources on IJV longevity suggest the importance of considering the characteristics of resources that partners contribute to IJVs in the studies of IJV longevity.

Taken together, our findings reveal the differing effects that the same strategy could have on different dimensions of firm performance. It also confirms that firm performance is a multidimensional construct and researchers should treat different dimensions separately in their assessment of firm performance.

Before drawing any conclusions from this study, it should be noted that this study has its limitations. The most notable one is the fact that our empirical results were derived from a sample of Japanese small and medium enterprises and hence the concern that the findings might be country-specific. For example, Japanese culture emphasizes collectivism (Hofstede, 1980). This could be an underlying reason for the observation of an extensive use of partners from home country in our study. This pattern may not hold for firms from a different country such as U.S. which emphasizes individualism. Therefore, it is important for future studies to use samples of firms from other countries such as U.S. to test and extend the generalizability of our findings.

Another limitation of the study is the assumption that IJV termination is an indicator of IJV failure. Although this is a traditional assumption in many empirical studies on IJVs over the last three decades, recent studies have shown that IJVs can also terminate because of the fulfillment of one or more partners' strategic objectives (Reuer and Zollo, 2000). It would be useful to investigate the outcomes of IJV termination in future studies to have a direct measure of IJV success or failure.

Further, this study focused on equity joint ventures. Internationalizing SMEs can use alternative modes such as non-equity strategic alliance. Future study could extend the framework in this study to the context of non-equity strategic alliance and examine whether this study's results are generalizable in non-equity strategic alliances. In a similar

way, future studies could examine the generalizability of our model in IJVs established by larger firms. A more meaningful way to extend this study is to compare equity joint ventures and non-equity strategic alliances or compare joint ventures established by SMEs and by larger firms to determine how they differ in different contexts.

In addition, there are other aspects of partnering strategies to be investigated. For example, with two or more partners, IJVs involve a high level of management complexity which could become overwhelming over time and lead to IJV failure (Makino and Beamish, 1998). Trust between IJV partners also plays an important role in determining the outcome of IJVs (Lane et al., 2001). An integration of a wider spectrum of finer-grained partner characteristics will provide a more complete picture of the relationship between partnering strategies and the performance of SMEs' IJVs.

Finally, it would be ideal to examine the characteristics of all partners, both local partners and home country partners. It would be particularly interesting to de-compartmentalize the concept of local knowledge and study whether all aspects of local knowledge, such as age, industry experience and IJV experience, are relevant to IJVs. It would also be useful to investigate whether the variance in the quality and quantity of these aspects of local knowledge would have an impact on IJV performance. For our study, the investment location of our sample was spread across 43 countries and it would be impractical to collect data on local partners. Hence, the examination of the characteristics of partners was limited to those from home country. But de-compartmentalization of the concept of local knowledge could be an important direction for future studies on IJVs.

7. Conclusions

Our study has made several contributions to the entrepreneurship, strategy and internationalization literatures. First, we introduced institutional theory to complement the economic approach in the traditional IJV literature. We believe that our theoretical framework provides a more balanced view than prior studies because of the integration of social and economic considerations. Second, we differentiated between experience-based and size-based resources contributed by IJV partners and theorized their differential effects on IJV performance. This finer-grained classification of resources points to the importance of examining the nature of resources and its subsequent sustainability, an area that has received sparse attention in the literature.

Third, we directly examined the relative effectiveness of these two resources contributed by IJV partners, host country knowledge and size-based resources, on two dimensions of IJV performance, IJV profitability and IJV longevity. We find that the host country knowledge from local partners are more effective than that from home country partners to the improvements in IJV profitability at least in our sample of international joint ventures established by Japanese small and medium enterprises. The implication is that local partner presents a primary source of local knowledge and that small and medium enterprises should explore opportunities to seek partnership with local firms in their internationalization to benefit from immediate local access associated with such a partnering strategy.

Fourth, this study reveals the important role that large firms could play in the alleviation of the liabilities of newness and smallness faced by SMEs' international joint ventures. Partnering with large partners could be a viable strategy for SMEs' international joint ventures in the pursuit of longevity. However, small and medium enterprises should be aware of the higher bargaining power of large firms and the possible negative implications of this strategy for IJV profitability when seeking alliances with large firms in their international expansion.

Fifth, the contrasting effects that host country knowledge and size-based resources had on IJV longevity presents an advancement to the partner bargaining power argument by Inkpen and Beamish (1997) who only considered local knowledge, bargaining power and instability of IJVs. Our findings point to the importance of considering the characteristics of resources contributed by IJV partners. To promote IJV longevity, SMEs could contribute a diverse and continuing set of resources to reduce the obsolescence of the IJV bargain.

Finally, the different effects of the same strategy, such as the use of local partner, on different dimensions of IJV performance highlight the differential outcomes from the same strategy. When forming alliances, small and medium enterprises should be aware of the pros and cons of different partnering strategies for different organizational objectives and make the choice that helps to achieve the most important objective.

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